

ORIGINAL

DOCKET FILE COPY ORIGINAL  
Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure	)	CC Docket No. 91-213
and Pricing	)	
	)	
Usage of the Public Switched	)	CC Docket No. 96-263
Network by Information Service	)	
and Internet Access Providers	)	

TO: The Commission

COMMENTS OF THE WESTERN ALLIANCE

Benjamin H. Dickens, Jr.  
Gerard J. Duffy

Blooston, Mordkofsky, Jackson  
& Dickens  
2120 L Street, N.W., Suite 300  
Washington, D.C. 20037  
(202) 659-0830

DATED: January 29, 1997

[Signature]

## Table of Contents

<u>Table of Contents</u> . . . . .	i
Summary . . . . .	ii
The Western Alliance . . . . .	4
Access Charges Comprise The Major Component Of Rural Telephone Company Revenues . . . . .	6
Under-Depreciation of Existing Rural LEC Assets Also Mandates Caution In Adjusting Access Charge Rules . . . . .	8
Separations Changes Should Be Studied And Completed Before Access Charge Changes . . . . .	10
Disallowance Of Previously Required LEC Investments And Expenses Is Unauthorized, Unlawful And Unconstitutional . . . . .	11
USF Does Not Constitute Double Cost Recovery And Should Not Reduce Interstate Costs . . . . .	19
Any Changes To The Transport Interconnection Charge Should Continue To Recover The Costs Included Therein . . . . .	21
Existing SLC Caps Should Not Be Removed For Second Residential Lines Or Multiple-Line Businesses . . . . .	22
LECs Should Not Be Required To Charge End Users For Terminating Access . . . . .	25
The Commission Should Permit Pricing Flexibility For Rural LECs . . . . .	25
Conclusion . . . . .	26

### Summary

As it addresses access charges, the Western Alliance urges the Commission to keep in mind that rural areas are different from each other as well as from urban and suburban areas, and that rural local exchange carriers (LECs) depend upon access charges for a much larger and more indispensable portion (from 40 to 75 percent) of their revenues than the predominately-urban price cap LECs. As a result, the large and rapid access charge reductions sought by the interexchange industry pose a serious threat to the viability, service quality and future infrastructure investment of rural LECs, as well as to the economic development and quality of life of their geographically isolated service areas.

As a preliminary matter, the Commission should not restructure its access charge rules relating to rural LECs until their prescribed depreciation rates are adjusted to eliminate the current under-depreciation deficiencies and until the existing interstate/intrastate separations rules are reviewed by an appropriate Federal-State Joint Board.

Moreover, when it does address its access charge rules, the Commission should not abandon pricing on the basis of verifiable actual costs in favor of pricing on the basis of untested and subjective "forward-looking costs." In particular, it must not disallow previously allowed or mandated investment and expenses as a means of reducing access charges. Such an approach would violate, inter alia, the hearing requirements of the Administrative Procedure Act, the ratemaking requirements of Sections 204 and 205

of the Communications Act, the Takings Clause of the Fifth Amendment, the judicial prohibition against retroactive application of administrative rules, and the long-established "regulatory compact" between rural LECs and their federal and state regulators.

As regards the NPRM's specific proposals, the Western Alliance: (a) opposes reduction of the interstate costs recovered via access charges by the amount of support received by rural LECs from future universal service mechanisms; (b) supports modification of the existing Transport Interconnection Charge as long as the actual costs included therein are recovered in a reasonable and timely fashion; (c) opposes the removal of the caps on the Subscriber Line Charge (SLC) for second residential lines and multiple-line businesses in rural areas; and (d) opposes the assessment of terminating access charges on end users.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure	)	CC Docket No. 91-213
and Pricing	)	
	)	
Usage of the Public Switched	)	CC Docket No. 96-263
Network by Information Service	)	
and Internet Access Providers	)	

TO: The Commission

**COMMENTS OF THE WESTERN ALLIANCE**

The Western Alliance submits its comments in response to the Commission's Notice Of Proposed Rulemaking, Third Report And Order, And Notice Of Inquiry (Access Charge Reform), FCC 96-488, released December 24, 1996 (NPRM).

The NPRM purports to deal primarily with the access charge structure for price cap local exchange carriers (LECs), and indicates that a separate review for rate-of-return LECs will be initiated in 1997. However, Western Alliance members are concerned not only that some of the NPRM's proposals apply expressly to rural and other small LECs, but also that other of its proposals may serve as models or precedents for the future rate-of-return proceeding.

As it formulates proposals and rules that directly or indirectly affect rural LECs, the Commission should keep in mind that rural areas are different -- not only from urban and suburban

areas, but also from each other. The technical, economic and demographic problems of providing telephone service in the mountains of Wyoming differ not only from those of serving urban and suburban communities, but also from those of serving the bayous of Louisiana, the deserts of Arizona, the ranches of Montana, the woodlands of Oregon, the farms of Kansas, the Native American reservations of South Dakota, and the frozen tundra of Alaska. Unlike the Bell System which developed under common management and technology during most of this century, rural LECs and telephone systems have been designed and operated as local responses to unique local service needs that would not or could not be met by the larger LECs. Hence, a "one size fits all" approach to access pricing (or universal service cost recovery or interconnection pricing) for the approximately 1,300 very different small LECs is neither feasible nor reasonable nor equitable.

Instead, the Commission should base its actions in this and any subsequent rate of return proceeding on the following considerations:

1. Adequate telecommunications facilities and services are extremely important to the economic development, education, health care, and overall quality of life in rural communities. Because they reduce the traditional disadvantages of distance and isolation, telecommunications facilities and services are even more important to rural areas than to urban and suburban areas.
2. Most rural LECs are very small businesses that serve rough and sparsely populated areas, and enjoy few economies of scope or scale. They possess neither the profit margins nor the financial resources to withstand revenue fluctuations from federal economic experiments without curtailing their current services and future infrastructure investment.

3. Access charges range from 40 percent to 75 percent of the operating revenues of rural LECs, and average about 60 percent thereof. Thus, they comprise a much larger and more indispensable revenue element for rural LECs than for price cap LECs.

The NPRM appears to equate "access reform" with a major reduction in LEC access revenues. Such reductions will have substantial, real world consequences for rural LECs and the people and areas they serve. Regardless of the economic theories or models that the Commission may favor at the moment, the hard and inescapable fact is that rural LECs can remain in operation only if they take in enough actual dollars to pay their vendors and employees, and to repay their existing loans. If reductions in the access revenues of rural LECs are not offset by increases in other revenues, they will be able to survive only by decreasing their investment, services and/or service quality.

Specifically, the Western Alliance herein: (a) demonstrates the critical significance of access charges to rural LECs; (b) confirms that the existing telecommunications plant of rural LECs is under-depreciated, and that this problem must be resolved before changes are made in the existing access charge structure; (c) shows that proposals for the disallowance of LEC investment and expenses and for the replacement of such actual costs with untested and subjective "forward-looking" cost models violates the Takings Clause of the Fifth Amendment and other legal standards; (d) opposes reduction of the interstate costs recovered via access charges by the amount of support received by rural LECs from the future universal service mechanism; (e) supports modification of

the existing Transport Interconnection Charge as long as the actual costs included therein are recovered in a reasonable and timely alternative manner; (f) opposes the removal of the caps on the Subscriber Line Charge (SLC) for second residential lines and multiple-line businesses in rural areas; and (g) opposes the assessment of terminating access charges on end users.

### **The Western Alliance**

The Western Alliance is comprised of the Western Rural Telephone Association (WRTA) and the Rocky Mountain Telecommunications Association (RMTA). These trade associations represent nearly 250 rural telephone companies in the states west of the Mississippi River (including Alaska and Hawaii), plus the Pacific Island territories.

Western Alliance members include commercial telephone companies (many family-owned) and cooperatives. Most members serve less than 3,000 access lines, and have relatively small revenue streams. They serve sparsely populated farming and ranching areas, remote mountain and desert communities, and Native American reservations. These generally are areas that the former Bell System and other large carriers ignored or declined to serve during the initial construction and development of the U.S. telephone network.

Western Alliance members have brought telephone service to their rural areas long before (if ever) profit maximizing entities would have deemed it economically feasible. Once there, they frequently have been required (e.g., by "carrier of last resort"



obligations) to construct lengthy loops (often 10-to-25 miles long, and sometimes as much as 40-to-70 miles long) over mountains, deserts and similar rough and unpopulated terrain to serve remote customers or customer clusters. As a result, Western Alliance members serve an average of only 3.24 subscribers per mile along their routes, and have per-subscriber loop costs far in excess of the national average. Likewise, they have had to acquire and install switches to serve their relatively small exchanges which average less than 500 subscribers per exchange. The inability of such small exchanges to generate significant economies of scale and scope means that their per-subscriber local switching costs are also far in excess of the national average.

As a quid pro quo for making investments that would not have been made (and serving customers that would not have been served) by most unregulated businesses, Western Alliance members have been permitted to recover a critical portion of their investment and operating costs via the existing access charge and universal service mechanisms. Because of their small revenue bases and high costs (measured and paid in actual dollars, rather than hypothetical "forward-looking" dollars), members do not have the assets and cash flows necessary to withstand sharp reductions or fluctuations in particular revenue categories without curtailing their investment and services, increasing their rates, or defaulting on their loans. Unlike larger carriers, Western Alliance members do not have ready access to private capital markets, but rather obtain most of their financing via loans and

guarantees from the Rural Utilities Service (RUS, formerly Rural Electrification Administration) and the Rural Telephone Bank (RTB).

Notwithstanding their small size and harsh operating and financial environments, Western Alliance members and other rural telephone companies have had -- up to now -- an outstanding record of furnishing quality facilities and services at reasonable rates to their rural customers. Their service records and customer satisfaction levels are far superior to those of neighboring price cap LECs that still employ outmoded 1950-or-1960-vintage electro-mechanical switches and multi-party lines.

**Access Charges Comprise The Major Component  
Of Rural Telephone Company Revenues**

Rural LECs depend upon access charges for a much larger portion of their revenues than price cap LECs, and consequently are much more vulnerable to actual or potential reductions.

Price cap LEC data summarized in the NPRM indicate that interstate and intrastate access revenues constitute 33.8 percent of their regulated revenues, and that interstate access revenues comprise 25.8 percent of such revenues (NPRM, Table 1). These percentages are substantial, but nonetheless only half the size of the comparable access revenue components for rural LECs.

Access charges constitute the largest and most essential portion of total revenues for rural LECs. As indicated in Table A, interstate and intrastate access revenues<sup>1</sup> comprised, on the

---

<sup>1</sup> The Western Alliance estimates that interstate access revenues account for 75 to 85 percent of the total access revenues of its member companies.

average, 59.11 percent of the 1994 operating revenues of RUS borrowers in the Western Alliance states. Access revenue percentages ranged from 75.88 percent in Idaho to an artificially low 39.47 percent in Wyoming<sup>2</sup>, with a median of 64.56 percent for the 23 states.

**TABLE A**

**Access Revenues in Western Alliance States**

<u>State</u>	<u>Inter/Intrastate Access Revenue</u>	<u>Total Net Operating Revenue</u>	<u>Access Portion of Net Operating Revenue</u>
AK	\$ 94,607,688	\$133,393,998	70.92%
AR	102,436,173	223,762,933	45.78%
AZ	28,482,561	55,917,211	50.94%
CA	73,199,521	129,116,648	58.69%
CO	17,542,702	30,174,312	58.14%
IA	53,628,755	73,429,832	73.03%
ID	16,760,432	22,087,561	75.88%
KS	59,001,380	91,389,618	64.56%
LA	76,435,113	146,029,497	52.34%
MN	151,583,426	229,545,094	66.04%
MO	379,570,272	599,572,709	63.31%
MT	50,079,247	66,337,561	75.49%
ND	30,965,890	50,528,420	61.28%
NE	47,598,199	69,798,227	68.19%
NM	39,109,329	60,351,129	64.80%
NV	3,931,596	6,100,537	64.45%
OK	76,773,151	171,616,062	44.74%
OR	41,272,470	62,184,795	66.37%
SD	32,817,403	45,982,196	71.37%
TX	260,865,249	501,670,568	52.00%
UT	11,325,569	15,143,722	74.79%
WA	24,519,195	37,461,853	65.45%
WY	9,407,949	23,837,308	39.47%
	-----	-----	-----
TOTAL	\$1,681,913,270	\$2,845,431,791	59.11%
	=====	=====	=====

SOURCE: 1994 Rural Utilities Service data

These high access revenue ratios graphically demonstrate the need to proceed carefully with direct and indirect changes in the access charge structure for rural LECs. Significant reductions or

---

<sup>2</sup> The Western Alliance is aware that the RUS 1994 operating revenue data for Wyoming included substantial non-regulated revenues that should have been excluded, and that the accurate access revenue/net operating revenue percentage was over 50 percent.

fluctuations in an element representing 40-to-75 percent of a small company's revenues are not mere setbacks or signals from the market that adjustments are necessary. Rather, they are major convulsions that can thrust most rural LECs precipitously into real or near bankruptcy, wiping out their cash reserves and wreaking havoc with their operations, lender relationships and investment plans. This not only would be a grievous breach of the "regulatory compact" under which rural LECs have long served unwanted high-cost areas, but also would disrupt and impair essential telecommunications services for rural residents and businesses.

**Under-Depreciation of Existing Rural LEC Assets  
Also Mandates Caution In Adjusting Access Charge Rules**

Structural changes in access charges will bring to a head the critical industry problem of under-depreciation of telecommunications facilities.

The Commission has correctly recognized that under-depreciation of existing LEC assets will produce significant differences between access charges based upon actual costs and access charges based upon "forward-looking" costs (NPRM, para. 250). Even though the Commission has thus far proposed the use of subjective "forward-looking" cost approaches only for price cap LECs, it has asked all incumbent LECs to comment on the nature and extent of the present under-depreciation of their telecommunications assets.

Under-depreciation (also known as depreciation reserve deficiency) is a serious problem for rural LECs, particularly the many that have upgraded their switching and outside plant

facilities during recent years. For example, the Commission and its state counterparts have required many rural LECs to acquire or upgrade digital switches in order to provide equal access to interexchange carriers, and to offer a growing assortment of additional services (such as caller ID and originating line screening). Likewise, state commissions have required rural LECs to upgrade their outside plant to offer single-party service (where only party-line service was previously available). Finally, state and local agencies have required or pressured rural LECs to replace aerial wires with buried cable for reliability, safety and aesthetic reasons.

In the regulatory environment that has existed to date, the Commission has not prescribed depreciation rates for rural LECs, while state commissions have generally set long useful lives in order to keep depreciation expenses and local rates as low as possible. For example, one Western Alliance member has been required by its state commission to depreciate its central office equipment (COE) over a period of 10.26 years (actual useful life may be only 5 to 7 years), and its outside plant cable over a period of 17.45 years (actual useful life may be only 7 to 10 years). As a consequence, only 26 percent of the member's COE and outside plant investment will have been recovered through depreciation charges by the end of 1997.

As detailed below, it would be unlawful and unreasonable for the Commission to disallow (or otherwise preclude rural LECs from recovering) the non-depreciated costs of their facilities.

Therefore, as a necessary prerequisite for any access structure changes, the Commission and its state counterparts should revise their depreciation policies and prescriptions, and establish a sufficient transition period to enable the existing under-depreciation problem to be resolved.

**Separations Changes Should Be  
Studied And Completed Before Access Charge Changes**

The NPRM is putting the cart before the horse by proposing Commission revision of existing interstate access charge rules before an appropriate Federal-State Joint Board studies and revises the current interstate/intrastate separations rules.

If (as the NPRM indicates) the Commission intends to reduce, disallow or otherwise decrease the costs recovered via interstate access charges, the associated obligations of rural LECs to pay or repay their vendors, employees, creditors and investors will not disappear. Rather, if they want to remain in operation, one option for rural LECs will be to recover these costs instead from the intrastate jurisdiction via increased local service rates and/or intrastate access charges.

The Western Alliance understands that the Commission must complete reviews of specified interconnection and universal service rules within the statutory deadlines set by new Sections 251(d)(1) and 254(a) of the Act. However, neither "access reform" in general nor the present proceeding in particular are expressly required by the Act, nor are they subject to any deadline mandated by Congress.

The Telecommunications Act of 1996 did not address or limit the well-established requirements for federal-state cooperation in

jurisdictional separations matters set forth in Section 410 of the Act. Specifically, Section 410(c) still requires the referral of "any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations" to an appropriate Joint Board. The Commission cannot, and should not, unilaterally transfer costs presently recovered from the interstate jurisdiction to the intrastate jurisdiction by reducing or disallowing their recovery via interstate access charges. Rather, Section 410(c) requires a Joint Board to study and decide whether to change the relative portions of access-related costs recovered from the interstate and intrastate jurisdictions, before the Commission proceeds unilaterally to remove costs from interstate access charges and impose them directly or indirectly upon the intrastate jurisdiction.

**Disallowance Of  
Previously Required LEC Investments And Expenses  
Is Unauthorized, Unlawful And Unconstitutional**

The Commission's desire to abandon verifiable actual costs as the basis for access charges, in favor of untested and subjective "forward-looking costs," is a recurring theme throughout the NPRM. The driving goal appears to be to lower the access prices paid by interexchange carriers, with minimal consideration being given thus far to the impact of these cuts upon the LECs responsible for constructing, upgrading and maintaining essential segments of the network.

In fact, the NPRM goes so far as to discuss (as an apparently legitimate policy alternative) the disallowance of various

investments and expenses in order to drive down access charges after the abandonment of actual cost pricing. For example, on the basis of "estimates" by AT&T and MCI that actual LEC costs exceed the AT&T/MCI version of "forward-looking LEC costs" by 55-to-70 percent, the NPRM asks whether LECs (including small LECs<sup>3</sup>) should be permitted to recover any actual costs in excess of their hypothetical "forward-looking costs" (NPRM, paras. 247-48).

Similarly, the NPRM characterizes as a disadvantage of the potential "prescriptive approach" to access pricing the fact that a LEC might be able to demonstrate that its actual costs are significantly higher than its "forward-looking costs." The NPRM indicates that the Commission might then be required to determine "how much" of the difference the LEC should be allowed to recover (NPRM, para 143).

The NPRM further raises the specter of "prudence" reviews, many years after the fact, to determine whether differences between actual costs and "forward-looking costs" should be recoverable by incumbent LECs (NPRM, para. 247). It speculates whether the Commission should refer prudence reviews to state commissions for the conduct of "rate cases" under Section 410(a) of the Act (NPRM, para 258).

Finally, the NPRM invites comment whether LECs should be required to deal with differences between actual costs and "forward-looking costs" simply by "reducing their costs." It asks

---

<sup>3</sup> Although this portion of the NPRM supposedly did not apply to small LECs (NPRM, para. 53), the Commission nonetheless sought comment regarding its impact upon them.



how such decisions regarding full or partial cost recovery would affect small LECs (NPRM, para 259).

The Western Alliance believes that the Commission lacks authority under the Administrative Procedure Act, as well as the Communications Act, to disallow the specific actual costs long included in the revenue requirements of individual rate of return LECs via a general rulemaking. Rather, a proper adjudicatory proceeding -- namely, a Section 204 lawfulness hearing or a Section 205 rate prescription proceeding -- is necessary to review the specific investment and expenses included in a particular carrier's revenue requirement for "prudence" or disallowance purposes. The Commission may not lawfully disallow -- by fiat in a general rulemaking -- millions or billions of dollars of previously reasonable and acceptable investment in "used and useful" facilities (much of which was mandated by the Commission or its state counterparts). Rather, due process requires that individual LECs be afforded notice and the opportunity to be heard and to present evidence, before any particular investments or expenses traditionally included in their revenue requirements are removed therefrom.

Second, any Commission disallowance of legitimately-incurred LEC investment and expenses for the purpose of forcing access rates down to the levels where the Commission and interexchange carriers desire them, constitutes a taking of private property for public use without just compensation in violation of the Takings Clause of the Fifth Amendment. In reviewing "taking" claims, the Courts

have considered the following three factors: (1) the nature of the governmental action; (2) the extent to which the regulation has interfered with "distinct investment-backed expectations"; and (3) the economic impact of the regulation on the claimant. Jones Truck Lines, Inc. v. Southland Furniture, Inc. 57 F. 3d 642, 650 (8th Cir. 1995).

For most Western Alliance members and other rural LECs, the "nature" of a Commission change from access pricing based upon actual costs to access pricing based upon "forward-looking costs" will be a substantial decrease in access revenues and an effective disallowance of substantial existing investment. One Western Alliance member has studied the implications of Total Element Long Run Incremental Cost (TELRIC) pricing upon its revenues, and has found that its 1993 revenues of \$174 per month per line based upon its actual costs would have dropped: (a) to \$42 per month per line under the default proxy prices established in the Commission's Local Interconnection proceeding; (b) to \$97 per month per line under estimated proxy prices based upon the Benchmark Cost Model, Version 2 (BCM2); and (c) to \$115 per month under a TELRIC model developed by the National Exchange Carrier Association (NECA). In other words, a Commission-mandated change from actual costs to "forward-looking costs" would place at risk as much as 75.9 percent, or 44.3 percent, or 33.9 percent of the member rural LEC's per-line revenues.

The variations in these estimates point out an equally significant flaw in the "nature" of the Commission's desired change

to access pricing based upon "forward-looking costs" -- the lack of any objective and verifiable model. Because TELRIC, Total Service Long Run Incremental Cost (TSLRIC), and other "forward-looking cost" models are based upon the subjective and unverifiable "long run" and "incremental" costs of allegedly "efficient" technologies, their assumptions and projections can be readily manipulated to estimate whatever "costs" are needed to achieve the prices which their proponents desire. Hence, whereas "forward-looking costs" may be an appropriate internal device for firms to employ when freely determining the prices which they will charge in competitive markets, they are far too subjective and too prone to political pressures to be employed by administrative agencies to set contested prices in a regulated industry.

The Western Alliance is mindful that the Commission has previously defended "forward-looking pricing" on the basis that the end result reached, and not the methodology used, is dispositive with respect to "takings" claims. First Report and Order (Implementation of the Local Competition Provisions of the Telecommunications Act of 1996), FCC 96-325, released August 8, 1996, at para. 734, citing Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944). However, in seeking to defend the end result of the slashed "forward-looking" prices it prescribed in the Local Competition proceeding, the Commission indicated the possibility that the resulting shortfalls might be "made up" as a consequence of this proceeding. First Report and Order, at para 739. It now appears that the Commission has reversed its position

on this point, and that it may impose substantial access revenue requirement disallowances on top of the interconnection price decreases it has encouraged in the First Report and Order.

The Western Alliance further submits that the historic inclusion of actual LEC investment and expenses in interstate access rates, not to mention the Commission's explicit or implicit approval of such actual costs during its annual or bi-annual reviews of access tariffs, precludes retroactive disallowance of such costs. See, e.g. Bowen v. Georgetown University Hospital 488 U.S. 204, 208 (1988) (administrative rules will not be construed to allow retroactive application unless retroactive power is expressly conveyed by Congress). Given that the Commission has permitted the access tariffs of NECA and other rural LEC to become effective for more than a decade without disallowance of significant costs (and, in fact, has mandated certain investments and expenses), LECs and their investors certainly had every reason to believe that their government-approved (or government-mandated) investments would earn a return, rather than be confiscated. Because these costs will not simply disappear as a result of regulatory fiat, any decision to disallow them will have a clear retroactive effect on telephone company investors who, in good faith, have made such investments and charged rates, subject to close regulation by the Commission, for over a decade.

Third, the Western Alliance notes that the Supreme Court has determined that government agencies may be liable for breach of contract where they induce firms to enter into transactions by

promising particular regulatory treatment, and then fail to provide such treatment (because of their own policy changes or intervening statutory changes). In United States v. Winstar Corp., 116 S. Ct. 2432 (1996), the Federal Home Loan Bank Board (FHLBB) was found to be liable in damages for breach of contract because it had induced several then-healthy savings and loan associations (S&Ls) to merge with failing S&Ls by promising them favorable accounting treatment for "supervisory goodwill," and then was prevented by subsequent federal legislation from affording such treatment. Here, Western Alliance members and other rural LECs have been induced by the Commission and state commissions to construct facilities and serve customers in high-cost areas that most unregulated businesses would not serve, in return for assurances that they could recover their investments, plus a reasonable return. If the Commission proceeds to violate this "regulatory compact" after rural LECs have invested millions of dollars in reliance thereupon, it may render the government liable for the non-depreciated portion of rural LEC investment, plus a reasonable measure of lost profits.

Fourth, rural LECs have long been subject to close and effective "prudency" reviews of their investments and operations by RUS, RTB, and their own investors. The typical Western Alliance member is a small business, and lacks the massive cash flows and ready access to private capital markets that would allow it to invest imprudently or enroll its owners and managers in the ranks of the rich and famous. Rather, Western Alliance members and other rural telephone companies must rely primarily upon the RUS and RTB

for the loans and guarantees necessary to finance the major portion of their plant and switch investments, and must comply with the eligibility, coverage, service and feasibility regulations of those agencies before receiving such financing. Among other things, prospective rural telephone company borrowers must prove to the RUS during a lengthy and detailed application process that: (a) the requested loan will be repaid on time; (b) the telephone market projections upon which the loan is based are reasonable; (c) the project is economically feasible on the basis of projected revenues and expenses, net income, maximum debt service, and rate of return on investment; (d) appropriate financial and managerial controls are in place; and (e) adequate telephone service will be made available to the widest practicable number of rural users during the life of the loan. 7 C.F.R. § 1735.51. These RUS and RTB procedures are more than sufficient to ensure that rural telephone companies invest prudently and operate efficiently.

Finally, no public interest reasons justify confiscation or disallowance of LEC investments. Rather, interstate access and long distance competition have flourished without drastic disallowance of LEC access costs<sup>4</sup>.

---

<sup>4</sup> The Commission reports that there were 83 interexchange carriers in 1993, 97 carriers in 1994, and 130 carriers by 1995. The Commission further indicates that similar growth has occurred among competitive access providers, reporting 20, 30 and 57 providers in each of the above years, respectively. (Telecommunications Industry Revenue: TRS Fund Worksheet Data, Industry Analysis Division, Common Carrier Bureau, December 1996 [1995 Data], February 1996 [1994 Data], and December 1994 [1993] Data.)

**USF Does Not Constitute Double Cost Recovery  
And Should Not Reduce Interstate Costs**

The Western Alliance recognizes that access charges and universal service support mechanisms are both designed to recover LEC costs. However, the real danger of this proceeding and CC Docket No. 96-45 is not that some costs might be double recovered as the Commission appears to believe (NPRM, para. 244), but rather that rural and other LECs will be unlawfully prevented from recovering major portions of their actual LEC costs.

At this time, concerns regarding the interrelation of access charges and universal service support cannot be addressed substantively until the Commission fleshes out the many holes in the Joint Board's Recommended Decision (Federal-State Joint Board on Universal Service), CC Docket No. 96-45, FCC 96J-3, released November 8, 1996. Neither the Joint Board nor the Commission have yet proposed specific universal service support mechanisms for high-cost areas. Among other things, the industry does not yet have any clear idea: (a) what specific mechanisms and/or benchmarks will be employed to calculate support for particular carriers or areas; (b) what the overall size of the future high-cost fund might be; or (c) whether contributions will be made on the basis of interstate or interstate/intrastate revenues. Virtually the only thing clear to Western Alliance members is that the Joint Board's proposed elimination of universal service support for second residential lines, second residences and multiple-line businesses is likely to reduce substantially the support received by rural LECs during the frozen transition period and thereafter.

In this uncertain and ill-defined environment, the Western Alliance cannot know what portions of the costs of its various members will be recovered by future access charge structure(s) and/or universal service support mechanism(s). However, the Commission's curious attraction to hypothetical "forward-looking" costs and untested proxy models (plus the NPRM's troubling references to the potential disallowance or denial of recovery of prior LEC investments) has given rise to far more credible fears by rural and other LECs that substantial LEC costs will not be recovered than that some costs might be double-recovered.

Moreover, when the nature, size and composition of future universal service support mechanisms finally becomes clear, they will serve a different function than access charges and should not be employed to reduce the interstate costs recovered via access charges. For example, the universal service support mechanism(s) for high-cost areas will support the following core services: (1) voice grade access to the public switched telecommunications network; (2) DTMF (touch-tone) signaling or its functional digital equivalent; (3) single party service; (4) access to emergency services; (5) access to automated or live operator services; (6) access to interexchange service for the placement and receipt of interexchange calls; and (7) access to directory assistance. Recommended Decision, at paras. 48-52. With the exception of "access to interexchange service," these core services are primarily local services, and the clear purpose of the high-cost support mechanism is to allow them to be offered at reasonable and



affordable local rates. Likewise, the existing Universal Service Fund (USF) was established to recover costs shifted to the intrastate jurisdiction when the Subscriber Plant Factor (SPF) was phased down to 25 percent. Decision And Order (Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board), CC Docket No. 80-286, 96 FCC 2d 781 (1984).

Whereas Dial Equipment Minutes (DEM) weighting and Long Term Support (LTS) are presently included in the access charge structure, the Western Alliance understands that the costs presently recovered via DEM weighting and LTS are not addressed in the proxy models under consideration in CC Docket No. 96-45. Consequently, there is no reason or need to subtract support received by rural LECs from the current USF or any future revised universal service support mechanism from the interstate costs used to develop their access charges. Rather, universal service support should be assigned to the intrastate jurisdiction, or treated as an intrastate expense adjustment recovered from the intrastate jurisdiction to keep intrastate rates affordable.

**Any Changes To The Transport Interconnection Charge  
Should Continue To Recover The Costs Included Therein**

The Western Alliance does not object to the restructuring of the present residual Transport Interconnection Charge (TIC) to shift some of the costs included therein to local switching, tandem switching and other appropriate categories. However, any such modifications must recognize that the costs included in the TIC -- for example, tandem switching facilities and expenses, analog end office multiplexers, host/remote connecting facilities, and